

# California Courts Invalidate Board Diversity Laws; State to Appeal

In the past six weeks, two separate Superior Courts in Los Angeles County have ruled that recently-adopted California laws mandating minimum quotas for racially and gender diverse directors on the boards of public companies headquartered in California are unconstitutional. On April 1, 2022, the L.A. County Superior Court granted plaintiffs' motion for summary judgment striking down Assembly Bill 979, California's board diversity statute for "underrepresented communities" (*Crest v. Padilla II*). On May 13, 2022, a second L.A. County Superior Court found Senate Bill 826, which required the inclusion of a specified number of female members on corporate boards, was invalid (*Crest v. Padilla I*). In each case, the relevant law was held to violate the Equal Protection Clause of the California Constitution.

However, last week the California Secretary of State announced that the state intends to appeal the decision in *Crest v. Padilla I*.

## Background

### *Senate Bill 826*

In 2018, Governor Jerry Brown signed into law SB 826 which amended the state's General Corporation Law to require publicly-listed corporations with their principal executive offices located in California to have a minimum of one female member on their Board of Directors by December 31, 2019 and a specified number of female members (depending on the size of the Board) on their Board of Directors no later than December 31, 2021.

### *Assembly Bill 979*

Two years later, in 2020, Governor Gavin Newsom signed into law a similar bill, AB 979, which amended the California General Corporation Law to require publicly-listed corporations with their principal executive offices located in California to have a minimum number of directors from "underrepresented communities" on their Board of Directors. For this purpose, a director from an underrepresented community was one who self-identifies as "Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual or transgender." Similar to SB 826, AB 979 required at least one member of an "underrepresented community"

be added to the Board of Directors by December 31, 2021 and a specified number of self-identified underrepresented community members (depending on the size of the Board) be added no later than December 31, 2022.

Each law provided that the failure to meet the applicable requirement by the specified date would subject covered corporations to a monetary penalty in the amount of \$100,000 (for an initial violation) and \$300,000 (for subsequent violations).

Both laws were almost immediately challenged following their enactment on constitutional grounds by Judicial Watch, a conservative activist foundation that monitors the actions of government officials.

## The Superior Court Decisions

Following lengthy journeys through the California judicial system, on April 1, 2022, a L.A. County Superior Court judge issued a summary judgment order in *Crest v. Padilla II* finding that AB 979 violated the Equal Protection Clause of the California Constitution. A little more than five weeks later, following a bench trial a second L.A. County Superior Court judge reached the same conclusion with respect to SB 826 in *Crest v. Padilla I*. In both cases, the Court found that the state had failed to prove that the laws met a compelling government interest and were narrowly tailored to serve that compelling interest.

Presumably, the Secretary of State believes that her appeal has a stronger chance of being successful on the "narrowly tailored argument" in *Crest v. Padilla I*, which is why she immediately announced her decision to appeal once that ruling had been issued while remaining silent following the outcome in *Crest v. Padilla II*.

## What's Next?

The State of California has 60 days after entry of judgment to file an appeal. Consequently, it's possible, albeit unlikely, that the Secretary of State may file a separate appeal in *Crest v. Padilla II*. It looks as if she believes that she has the stronger argument with *Crest v. Padilla I*.

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In any case, the issue of director diversity has registered with many publicly-listed companies, and is unlikely to be changed by the ultimate outcome in California. Many institutional shareholders are now closely scrutinizing the composition of the Boards of Directors of their portfolio companies. In addition, SEC-approved changes to the Nasdaq listing requirements with respect to Board diversity go into effect this year, with most Nasdaq-listed companies already providing the required director diversity statistics. Shortly, the requirement that listed companies either have two directors from underrepresented communities on their Boards or explain why will take effect, most likely solidifying the level of diversity to some degree that California and a few other states have been promoting. One possible wrinkle to this movement continuing to gain momentum is that Judicial Watch

has also filed suit in the Fifth Circuit (which covers portions of Louisiana, Mississippi, and Texas) contesting the Nasdaq listing standard. Between that and the appeal by the State of California, this issue may be with us for a while longer.

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